

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 90A-0825-MW
DIAL FINANCE COMPANY OF CALIFORNIA,	)	
0195592, TAXPAYER, AND NORWEST	)	
FINANCIAL CALIFORNIA, INC.,	)	
1123481, ASSUMER AND/OR TRANSFEREE,	)	
ET AL.	)	

For Appellant:	John R. Kalligher Assistant Tax Counsel
For Respondent:	Eric J. Coffill Senior Staff Counsel

O P I N I O N

This appeal is made pursuant to section 25666<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Dial Finance Company of California, 0195592, Taxpayer, and Norwest Financial California, Inc., 1123481, Assumer and/or Transferee, et al., against proposed assessments of additional franchise tax in the amounts and for the income years as follows:

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<sup>1/</sup> Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income year in issue.

	<u>Income Years</u>	<u>Proposed Assessments</u>
Dial Finance Company of California, 0195592, Taxpayer, and Norwest Financial California, Inc., 1123481, Assumer and/or Transferee	1978 1979 1980 1981	\$126,971 99,547 72,039 202,751
Dial Financial Corporation, 0738809, Taxpayer, and Norwest Financial California, Inc., 1123481, Assumer and/or Transferee	1978 1979 1980 1981	5,924 7,204 4,424 14,814

The issue in this appeal is whether dividends received by the appellants from an insurance company subsidiary were properly included in their combined reports as business income.

Dial Finance Company of California (Dial California) was a more-than-50-percent-owned subsidiary of Dial Financial Corp. (Dial), a Missouri corporation domiciled in Iowa. Both were engaged in making personal loans. Centurion Life Insurance Company (Centurion) was a subsidiary of Dial which did business in California and offered various kinds of insurance exclusively to customers of Dial and Dial's subsidiaries. From 1978 through 1981, Centurion paid dividends to Dial totaling over \$22 million.

Dial and Dial California, operating as a unitary business, computed their California franchise tax liability using combined report procedures. Centurion, as an insurance company, paid only a gross premiums tax and its income and factors were excluded from Dial's combined reports. Dial treated the dividends paid to it by Centurion as nonbusiness income and excluded them from business income and the sales factor computation for California. The Franchise Tax Board (FTB) determined that the dividends constituted apportionable business income and included them in the denominator (but not the numerator) of the sales factor.

Appellants argue that the dividend income from Centurion was nonbusiness income. They acknowledge that Centurion is unitary with Dial under the unitary analysis of Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), *affd.*, 315 U.S. 501 [86 L.Ed.991] (1942), and Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947), but argue that, since the California Constitution and Legal Ruling 385 preclude insurance companies from being included in Dial's combined report,<sup>2/</sup> Centurion cannot be considered part of Dial's unitary business and a "unitary

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<sup>2/</sup> The California Constitution exempts insurance companies from the franchise tax and subjects them to a gross premiums tax which is in lieu of all other taxes. (Cal. Const., art. XIII, § 28, subd. (f).) Accordingly, the Franchise Tax Board excludes insurance companies from combined reports and formula apportionment procedures. (See generally

analysis" cannot be made of the relationship of the business activities of Dial and Centurion. Rather, appellants argue, the determination of whether the dividends are business or nonbusiness income "can only be decided by applying the tests contained in Revenue and Taxation Code § 25120, subd. (a) to Dial's use of the Centurion stock itself, without regard to any connection between Dial's and Centurion's operations." (App. Reply Br. at 7.) Appellants assert that the stock of Centurion was acquired and managed as an investment and, therefore, under section 25120, the dividends paid on the stock were nonbusiness income. Appellants also argue that classifying the dividends as business income violates article XIII, section 28, of the California Constitution and results in inequitable double taxation. In addition, they contend that section 24410, which excludes from the income of a corporation commercially domiciled in California dividends received from an insurance company, violates the equal protection and the commerce clauses of the United States Constitution.

The FTB contends that appellants misunderstand the combined report concept and its relationship to the unitary business analysis and that the dividend income paid to Dial was properly classified as business income. It also argues that this board is not the proper forum for the constitutional issues raised by the appellants. We agree with the FTB on both points.

Contrary to appellant's assertions, unitary business analysis does apply even if an insurance subsidiary cannot be included in the combined report. Simply because the operations of an insurance company cannot be included in the combined report does not negate the fact that an insurance company is part of the unitary business. Inclusion in a combined report does not determine whether companies are unitary with one another, it is the fact that companies are engaged in a unitary business that determines whether they can be included in a combined report. Since, as appellants admit, Dial and Centurion are part of a single unitary business, it is perfectly appropriate to apply unitary business principles to determine if these dividends are includible as business income, just as would be done with the dividend income paid by a less-than-wholly owned subsidiary (which cannot be included in the combined report solely because of the ownership requirement) to a parent engaged in a unitary business.

The Uniform Division of Income for Tax Purposes Act (UDITPA) (Rev. & Tax. Code, §§ 25120-25139) distinguishes between "business income," which must be apportioned by formula, and "nonbusiness income," which is specifically allocated by situs or commercial domicile. The UDITPA definition of business income involves two separate tests, the transactional test and the functional test. Under the functional test, income is business income if the acquisition, management, and disposition of the income-producing property constitute integral parts of the taxpayer's regular trade or business operations. (Appeal of Kroehler Manufacturing Co., Cal. St. Bd. of Equal., Apr. 6, 1977.) If the income-producing property in question is integrally related to the unitary business activities of the taxpayer, the income is business income subject to formula apportionment. (Appeal of Standard Oil Company of California, Cal. St. Bd. of Equal., Mar. 2, 1983.)

(..continued)

FTB 385, Cal. St. Tax. Rep. (CCH) New Matters ¶ 205-232.)

The income-producing property in the instant appeal, the stock of the unitary insurance subsidiary, is clearly integrally related to the unitary business operations of the corporate group. In analogous situations we have held that such income is business income subject to formula apportionment. (Appeal of Standard Oil Company of California, supra; Appeal of Occidental Petroleum Corporation, Cal. St. Bd. of Equal., June 21, 1983.) We see no reason to deviate from these holdings in this appeal.

No prohibited taxation of insurance companies, nor impermissible double taxation, as alleged by appellant, is involved here. The income being included is dividend income of the parent recipient, not income of the payor insurance corporation. The fact that the Legislature has provided for the deduction of intercompany dividends in situations other than appellant's does not allow this board or the FTB to create new law to cover appellant's situation. We note that the FTB has properly included the income in the sales factor denominator and not in the numerator, giving it appropriate recognition in factors used to apportion business income. This is the only adjustment to full inclusion of the dividend income that is allowed under the law as it now stands.

Appellant also has offered certain constitutional arguments with respect to the dividend exclusion limitation contained in section 24410 of the Revenue and Taxation Code. However, we are prevented from considering such arguments in view of section 3.5 of article III of the California Constitution which precludes a state agency from determining that statutory provisions are unconstitutional or unenforceable.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding,  
and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Dial Finance Company of California, 0195592, Taxpayer, and Norwest Financial California, Inc., 1123481, Assumer and/or Transferee, et al., against proposed assessments of additional franchise tax in the amounts and for the income years ended as follows:

	<u>Income Years</u>	<u>Proposed Assessments</u>
Dial Finance Company of California,	1978	\$126,971
0195592, Taxpayer, and Norwest	1979	99,547
Financial California Inc., 1123481,	1980	72,039
Assumer and/or Transferee	1981	202,751
Dial Financial Corporation, 0738809,	1978	5,924
Taxpayer, and Norwest Financial	1979	7,204
California, Inc., 1123481,	1980	4,424
Assumer and/or Transferee	1981	14,814

be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of February, 1993, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Fong, Mr. Dronenburg, and Ms. Scott present.

Brad Sherman, Chairman

Matthew K. Fong, Member

Ernest J. Dronenburg, Jr., Member

Winnie Scott\*, Member

\_\_\_\_\_, Member

\*For Gray Davis, per Government Code section 7.9  
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